Contribution Rate Floors

Background

This matter came before the SCPP on recommendation of the Chair at the December 13, 2005, meeting. The 2005 Plan 1 Unfunded Liability subgroup had recommended minimum contribution rates (or rate floors) for the Plan 1 Unfunded Actuarial Accrued Liability (UAAL) for PERS and TRS beginning in 2009. The Chair recommended that the rate floors be removed from the bill addressing the Plan 1 UAAL and be included in a separate bill with rate floors not only for the Plan 1 UAAL, but also for the Plan 2/3 normal cost of PERS, SERS and TRS. (A rate floor for PSERS is not included, as it is premature. PSERS is a new plan that becomes effective July 1, 2006.)

This proposal is consistent with the SCPP's 2005 legislative proposal to adopt minimum contribution rates which function as a floor beneath which contribution rates are not intended to drop. It addresses contribution rate adequacy, an issue that was studied by the SCPP in the 2004 interim as part of "Contribution Rate Setting." (See Tab C of the 2004 Interim Issues Report.)

Committee Activity

Proposal:

December 13, 2005 – Full Committee

Recommendation to Legislature

Adopt minimum contribution rates beginning July 1, 2009, for the Plan 1 UAAL in PERS and TRS and the Plan 2/3 normal cost for PERS, TRS, and SERS.

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BILL REQUEST - CODE REVISER'S OFFICE

BILL REQ. #: Z-1009.1/06

ATTY/TYPIST: LL:mos

BRIEF DESCRIPTION: Establishing minimum contribution rates for the public employees' retirement system, the public safety employees' retirement system, the school employees' retirement system, and the teachers' retirement system.

AN ACT Relating to minimum contribution rates for the public employees' retirement system, the public safety employees' retirement system, the school employees' retirement system, and the teachers' retirement system; reenacting and amending RCW 41.45.020; adding new sections to chapter 41.45 RCW; and providing an effective date.

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF WASHINGTON:

Sec. 1. RCW 41.45.020 and 2004 c 242 s 37 and 2004 c 93 s 1 are each reenacted and amended to read as follows:

As used in this chapter, the following terms have the meanings indicated unless the context clearly requires otherwise.

(1) "Council" means the pension funding council created in RCW 41.45.100.

(2) "Department" means the department of retirement systems.

(3) "Law enforcement officers' and fire fighters' retirement system plan 1" and "law enforcement officers' and fire fighters' retirement system plan 2" means the benefits and funding provisions under chapter 41.26 RCW.

(4) "Public employees' retirement system plan 1," "public

employees' retirement system plan 2," and "public employees' retirement system plan 3" mean the benefits and funding provisions under chapter 41.40 RCW.

(5) "Teachers' retirement system plan 1," "teachers' retirement system plan 2," and "teachers' retirement system plan 3" mean the benefits and funding provisions under chapter 41.32 RCW.

(6) "School employees' retirement system plan 2" and "school employees' retirement system plan 3" mean the benefits and funding provisions under chapter 41.35 RCW.

(7) "Washington state patrol retirement system" means the retirement benefits provided under chapter 43.43 RCW.

(8) "Unfunded liability" means the unfunded actuarial accrued liability of a retirement system.

(9) "Actuary" or "state actuary" means the state actuary employed under chapter 44.44 RCW.

(10) "State retirement systems" means the retirement systems listed in RCW 41.50.030.

(11) "Classified employee" means a member of the Washington school employees' retirement system plan 2 or plan 3 as defined in RCW 41.35.010.

(12) "Teacher" means a member of the teachers' retirement system as defined in RCW 41.32.010(15).

(13) "Select committee" means the select committee on pension policy created in RCW 41.04.276.

(14) "Actuarial value of assets" means the value of pension plan investments and other property used by the actuary for the purpose of an actuarial valuation.

(15) "Public safety employees' retirement system plan 2" means the benefits and funding provisions established under chapter 41.37 RCW.

<u>(16) "Normal cost" means the portion of the actuarial present value of projected benefits and expenses that is allocated to a period, typically twelve months, under the actuarial cost method.</u>

<u>NEW SECTION.</u> **Sec. 2.** A new section is added to chapter 41.45 RCW to read as follows:

(1) Beginning July 1, 2009, a minimum 2.68 percent contribution is established as part of the basic state and employer contribution rate for the public employees' retirement system and the public safety

employees' retirement system, to be used for the sole purpose of amortizing the unfunded actuarial accrued liability in the public employees' retirement system plan 1. This minimum contribution rate shall remain effective until the actuarial value of assets in plan 1 of the public employees' retirement system equals one hundred twenty-five percent of the actuarial accrued liability or June 30, 2024, whichever comes first.

(2) Beginning September 1, 2009, a minimum 2.68 percent contribution is established as part of the basic state and employer contribution rate for the school employees' retirement system, to be used for the sole purpose of amortizing the unfunded actuarial accrued liability in the public employees' retirement system plan 1. This minimum contribution rate shall remain effective until the actuarial value of assets in plan 1 of the public employees' retirement system equals one hundred twenty-five percent of the actuarial accrued liability or June 30, 2024, whichever comes first.

(3) Beginning September 1, 2009, a minimum 4.71 percent contribution is established as part of the basic state and employer contribution rate for the teachers' retirement system, to be used for the sole purpose of amortizing the unfunded actuarial accrued liability in the teachers' retirement system plan 1. This minimum contribution rate shall remain effective until the actuarial value of assets in plan 1 of the teachers' retirement system equals one hundred twenty-five percent of the actuarial accrued liability or June 30, 2024, whichever comes first.

(4) Upon completion of each biennial actuarial valuation, the state actuary shall review the appropriateness of these minimum contribution rates and recommend to the legislature any adjustments as may be needed due to material changes in benefits or actuarial assumptions, methods, or experience.

NEW SECTION. **Sec. 3.** A new section is added to chapter 41.45 RCW to read as follows:

(1) Beginning July 1, 2009, a minimum contribution rate is established for the plans 2 and 3 normal cost as part of the basic state and employer contribution rate for the public employees' retirement system. The minimum contribution rate for the plans 2 and

3 employer normal cost shall equal the total contribution rate required to fund eighty percent of the plans 2 and 3 employer normal cost as calculated under the entry age normal cost method.

(2) Beginning September 1, 2009, a minimum contribution rate is established for the plans 2 and 3 normal cost as part of the basic state and employer contribution rate for the school employees' retirement system. The minimum contribution rate for the plans 2 and 3 employer normal cost shall equal the total contribution rate required to fund eighty percent of the plans 2 and 3 employer normal cost as calculated under the entry age normal cost method.

(3) Beginning September 1, 2009, a minimum contribution rate is established for the plans 2 and 3 normal cost as part of the basic state and employer contribution rate for the teachers' retirement system. The minimum contribution rate for the plans 2 and 3 employer normal cost shall equal the total contribution rate required to fund eighty percent of the plans 2 and 3 employer normal cost as calculated under the entry age normal cost method.

(4) Upon completion of each biennial actuarial valuation, the state actuary shall review the appropriateness of these minimum contribution rates and recommend to the legislature any adjustments as may be needed due to material changes in benefits or actuarial assumptions, methods, or experience.

NEW SECTION. **Sec. 4.** A new section is added to chapter 41.45 RCW to read as follows:

(1) Beginning July 1, 2009, a minimum contribution rate is established for the plans 2 and 3 normal cost as part of the required contribution rate for members of plan 2 of the public employees' retirement system. The minimum contribution rate for the plans 2 and 3 employee normal cost shall equal the total contribution rate required to fund eighty percent of the plans 2 and 3 employee normal cost as calculated under the entry age normal cost method.

(2) Beginning September 1, 2009, a minimum contribution rate is established for the plans 2 and 3 normal cost as part of the required contribution rate for members of plan 2 of the school employees' retirement system. The minimum contribution rate for the plans 2 and 3 employee normal cost shall equal the total contribution rate required

to fund eighty percent of the plans 2 and 3 employee normal cost as calculated under the entry age normal cost method.

(3) Beginning September 1, 2009, a minimum contribution rate is established for the plans 2 and 3 normal cost as part of the required contribution rate for members of plan 2 of the teachers' retirement system. The minimum contribution rate for the plans 2 and 3 employee normal cost shall equal the total contribution rate required to fund eighty percent of the plans 2 and 3 employee normal cost as calculated under the entry age normal cost method.

(4) Upon completion of each biennial actuarial valuation, the state actuary shall review the appropriateness of these minimum contribution rates and recommend to the legislature any adjustments as may be needed due to material changes in benefits or actuarial assumptions, methods, or experience.

NEW SECTION. **Sec. 5.** This act takes effect July 1, 2009.

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DRAFT FISCAL NOTE

REQUEST NO.

RESPONDING AGENCY:	CODE:	DATE:	BILL NUMBER:
Office of the State Actuary	035	12/21/05	Z-1008.1 / Z-1009.1

SUMMARY OF BILL:

This bill impacts the Plans 1 of the Public Employees' Retirement System (PERS) and the Teachers' Retirement System (TRS) by providing minimum contribution rates for paying the unfunded actuarial accrued liability (UAAL) in those plans. These minimum rates would become effective in 2009, and would remain in effect until the target funding ratio of 125% is achieved or the amortization date of June 30, 2024 is reached, whichever comes first.

The proposed legislation would also impact the Plans 2 and 3 of PERS, TRS and the School Employees' Retirement System (SERS) by establishing minimum employer contribution rates for the Plan 2/3 normal cost. These minimum contribution rates would equal the total contribution rate required to fund eighty percent of the Plan 2/3 employer normal cost as calculated under the entry age normal cost method. Similarly, minimum contribution rates would be established for Plan 2 members of PERS, TRS and SERS. These rates would equal the total contribution rate required to fund eighty percent of the Plan 2/3 employee normal cost as calculated under the entry age normal cost method. [It should be noted that this calculation does not change the underlying cost method for the Plans 2/3, which remains the aggregate funding method. Also, it should be noted that the Public Safety Employees' Retirement System (PSERS) is not included due to the fact that it is not effective until July 1, 2006, and it is too soon to reliably establish minimum contribution rates for that plan.]

The bill adds the definition of "normal cost" to the actuarial funding chapter. "Normal cost" is defined as "the portion of the actuarial present value of projected benefits and expenses that is allocated to a period, typically twelve months, under the actuarial cost method."

Effective Date: July 1, 2009

CURRENT SITUATION:

Payments to amortize the Plan 1 UAAL are normally collected as a component of employer contribution rates. According to current funding policy, unfunded liability for the Plans 1 is spread among all PERS, TRS, SERS and PSERS employers. This unfunded liability is also spread over time. Current funding policy requires that the UAAL be fully amortized by June 30, 2024. Payments for the Plan 1 UAAL have been suspended for the current biennium, and were suspended in the previous biennium. Regular payments are scheduled to resume July 1, 2007.

The Plan 2/3 normal cost is not currently subject to minimum contribution rates (or rate "floors"). It is collected as a component of Plan 2 and 3 employer contribution rates and Plan 2 member contribution rates.

MEMBERS IMPACTED:

The bill would impact all members of PERS, TRS and SERS by establishing minimum employer contribution rates in 2009. Similarly, minimum contribution rates would be established for Plan 2 members of PERS, TRS and SERS in 2009.

PERS Members	Plan 1	Plan 2	Plan 3	Total
Receiving a Benefit	54,568	12,106	222	66,896
Actives	17,829	118,572	19,855	156,256
Terminated & Vested	2,993	16,754	1,284	21,031

TRS Members	Plan 1	Plan 2	Plan 3	Total
Receiving a Benefit	34,624	1,127	541	36,292
Actives	9,862	7,470	49,302	66,634
Terminated & Vested	1,475	2,510	2,761	6,746

SERS Members	Plan 1	Plan 2	Plan 3	Total
Receiving a Benefit	0	1,097	481	1,578
Actives	0	20,424	29,430	49,854
Terminated & Vested	0	2,428	2,035	4,463

ASSUMPTIONS:

We project that the contribution rates for the amortization of the PERS and TRS Plan 1 UAAL and the normal cost rates for PERS, TRS and SERS Plans 2 and 3 beginning in 2009, will exceed the minimum rates, or floors in the bill throughout the remainder of the amortization period.

FISCAL IMPACT:

None.

There is no fiscal impact for a minimum contribution rate or floor because any additional contributions due to a floor would be offset by reduced contributions in future years.

The floor or minimum contribution rate would not impact rates in the long run. The short term increase in rates in years in which the floor applied would be offset by lower rates in future years. A floor could actually result in a long term savings to the extent that investment earnings from the extra contributions due to the floor are used to reduce future contribution requirements. We considered but did not include any cost impact for any issues related to market timing and when the extra contributions from the floor are invested.

State Actuary's Comments:

The determination that a floor would result in no additional cost and possibly a savings is based on the assumption that any temporary reserve or "cushion" that is built up from a floor is used to reduce future contribution requirements and not used to provide for benefit increases. If the extra contributions from a floor are used for benefit increases, then there would be a cost to having a floor.

STATEMENT OF DATA AND ASSUMPTIONS USED IN PREPARING THIS FISCAL NOTE:

The costs presented in this fiscal note are based on our understanding of the bill as well as generally accepted actuarial standards of practice including the following:

1. Costs were developed using the same membership data, methods, assets and assumptions as those used in preparing the September 30, 2004 actuarial valuation report of the Public Employees' Retirement System Retirement System, the Teachers' Retirement System, and the School Employees' Retirement System.

2. As with the costs developed in the actuarial valuation, the emerging costs of the System will vary from those presented in the valuation report or this fiscal note to the extent that actual experience differs from that projected by the actuarial assumptions.

3. Additional assumptions used to evaluate the cost impact of the bill which were not used or disclosed in the actuarial valuation report, or within the body of this fiscal note, include the following: None

4. The analysis of this bill does not consider any other proposed changes to the system. The combined effect of several changes to the system could exceed the sum of each proposed change considered individually.

5. This draft fiscal note is intended for use only during the 2006 Legislative Session.

6. The funding method used for Plan 1 utilizes the Plan 2/3 employer/state rate as the Normal Cost and amortizes the remaining liability (UAAL) by the year 2024. Benefit increases to Plan 2/3 will change the UAAL in Plan 1. The cost of benefit increases to Plan 1 increases the UAAL.

7. Plan 2/3 utilizes the Aggregate Funding Method. The cost of Plan 2/3 is spread over the average working lifetime of the current active Plan 2/3 members.

8. Entry age normal cost rate increases are used to determine the increase in funding expenditures for future new entrants. Aggregate rate increases are used to calculate the increase in funding expenditures for current plan members.

GLOSSARY OF ACTUARIAL TERMS:

Actuarial accrued liability: Computed differently under different funding methods, the actuarial accrued liability generally represents the portion of the present value of fully projected benefits attributable to service credit that has been earned (or accrued) as of the valuation date.

Actuarial Present Value: The value of an amount or series of amounts payable or receivable at various times, determined as of a given date by the application of a particular set of Actuarial Assumptions (i.e. interest rate, rate of salary increases, mortality, etc.)

Aggregate Funding Method: The Aggregate Funding Method is a standard actuarial funding method. The annual cost of benefits under the Aggregate Method is equal to the normal cost. The method does not produce an unfunded liability. The normal cost is determined for the entire group rather than an individual basis.

Entry Age Normal Cost Method (EANC): The EANC method is a standard actuarial funding method. The annual cost of benefits under EANC is comprised of two components:

- Normal cost; plus
- Amortization of the unfunded liability

The normal cost is determined on an individual basis, from a member's age at plan entry, and is designed to be a level percentage of pay throughout a member's career.

Normal Cost: Computed differently under different funding methods, the normal cost generally represents the portion of the cost of projected benefits allocated to the current plan year.

Pension Benefit Obligation (PBO): The portion of the Actuarial Present Value of future benefits attributable to service credit that has been earned to date (past service).

Projected Benefits: Pension benefit amounts which are expected to be paid in the future taking into account such items as the effect of advancement in age as well as past and anticipated future compensation and service credits.

Unfunded Liability (Unfunded PBO): The excess, if any, of the Pension Benefit Obligation over the Valuation Assets. This is the portion of all benefits earned to date that are not covered by plan assets.

Unfunded Actuarial Accrued Liability (UAAL): The excess, if any, of the actuarial accrued liability over the actuarial value of assets. In other words, the present value of benefits earned to date that are not covered by plan assets.